LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
JAN 3 1969
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. 897

FRANCIS G. COATES,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ALBERT R. CONNELLY
Attorney for Petitioner
One Chase Manhattan Plaza
New York, N. Y. 10005

Of Counsel:
GORDON GOOCH
DONALD STRAUBER
CRAVATH, SWAINE & MOORE

January 3, 1969

INDEX

PAGE

TABLE OF AUTHORITIES iii

OPINIONS BELOW 1

JURISDICTION 2

QUESTIONS PRESENTED 2

CONSTITUTIONAL PROVISION, STATUTE AND RULE INVOLVED 3

STATEMENT OF THE CASE 4

The Proceedings Below 4

The Commission's Charges 5

The Facts Relating to Coates 6

The Opinions Below 9

The District Court 9

The Court of Appeals 10

REASONS FOR GRANTING THE WRIT 10

I. IT IS NOT FRAUD OR DECEIT FOR A DIRECTOR TO PURCHASE STOCK ON INFORMATION WHICH HAS BEEN PUBLICLY ANNOUNCED AT A NEWS CONFERENCE 11

(a) Section 10(b) and Rule 10b-5 do not prohibit the use of inside information in the absence of fraud or deceit 11

(b) A director is not under a duty to disclose information which has already been announced by the corporation. In the absence of such a duty mere non-disclosure cannot constitute fraud or deceit 14

PAGE

II. A Director's Purchase of Stock on Information Which He Believes to be Available to the Public Does Not Constitute Fraud or Deceit Under Section 10(b) or Rule 10b-5 18

III. If Rule 10b-5 is Now Construed to Make Unlawful a Director's Purchase of Stock on Information Which Has Been Publicly Announced at a News Conference the Rule as so Construed is Invalid Under the Fifth Amendment for Failure to Provide an Ascertainable Standard of Conduct 21

Conclusion 26

TABLE OF AUTHORITIES

CASES: PAGE

Blau v. *Lehman*, 368 U. S. 403 (1962) 17

Blau v. *Max Factor & Co.*, 342 F. 2d 304 (9th Cir.), *cert. denied*, 382 U. S. 892 (1965) 13

Boutilier v. *Immigration and Naturalization Service*, 387 U. S. 118 (1967) 22

Boyce Motor Lines, Inc. v. *United States*, 342 U. S. 337 (1952) 21

J. I. Case Co. v. *Borak*, 377 U. S. 426 (1964) 10

Cochran v. *Channing Corp.*, 211 F. Supp. 239 (S. D. N. Y. 1962) 16

Keyishian v. *Board of Regents*, 385 U. S. 589 (1967) 21

Kraus & Bros., Inc. v. *United States*, 327 U. S. 614 (1946) 21, 22

Land v. *Dollar*, 330 U. S. 731 (1947) 10

Matter of Cady, Roberts & Co., 40 S. E. C. 907 (1961) 12, 22, 23, 24

Matter of Ruffalo, 390 U. S. 544 (1968) 22

SEC v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963) 15, 18

SEC v. *Chenery Corp.*, 318 U. S. 80 (1943) 15

A. B. Small Co. v. *American Sugar Refining Co.*, 267 U. S. 233 (1925) 21

Speed v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951) modified on other grounds 235 F. 2d 369 (3d Cir. 1956) 15

Strong v. *Repide*, 213 U. S. 419 (1909) 15, 16

United States v. *General Motors Corp.*, 323 U. S. 373 (1945) 10

PAGE

UNITED STATES CONSTITUTION:

Fifth Amendment 3

STATUTES AND RULES:

Securities Exchange Act of 1934:

Section 10(b), 48 Stat. 891, 15 U. S. C. § 78j ..... passim

Section 16, 48 Stat. 896, 15 U. S. C. § 78p 13, 15

Section 32(a), 48 Stat. 904, 15 U. S. C. § 78ff(a) 21

Rule 10b-5, 17 C. F. R. § 240.10b-5 ..... passim

OTHER:

Senate Reports Nos. 792 and 1455 (73d Cong. 2d Session, 1934) 13

IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. .....

FRANCIS G. COATES,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Company, et al.*, entered on August 13, 1968.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 401 F. 2d 833 and is printed as Appendix A hereto. The opinion of the United States District Court for the Southern District of New York is reported at 258 F. Supp. 262 and is printed as Appendix B hereto.

JURISDICTION

The judgment of the Court of Appeals was entered on August 13, 1968 and is printed as Appendix C hereto. Petitioner filed a petition for rehearing on September 20, 1968. That petition was denied on October 7, 1968. The jurisdiction of this Court is invoked pursuant to 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED

1. Does a director's purchase of stock on a national securities exchange on information which has been publicly announced at a news conference constitute fraud or deceit under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder?

2. Does a director's purchase of stock on a national securities exchange on information which he believes to be available to the public, constitute fraud or deceit under Section 10(b) and Rule 10b-5?

3. Is a director guilty of fraud or deceit for failing to comply with a standard of conduct proposed for the first time in the complaint herein?

4. Does Rule 10b-5, as construed by the Securities and Exchange Commission and the Court below, provide the ascertainable standard of conduct required by the Fifth Amendment to the United States Constitution?

CONSTITUTIONAL PROVISION, STATUTE AND RULE INVOLVED

Fifth Amendment to the Constitution of the United States:

> "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

Securities Exchange Act of 1934, § 10(b), 48 Stat. 891, 15 U. S. C. § 78j:

> "Sec. 10. Regulation of the Use of Manipulative and Deceptive Devices
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> ". . .
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regu-

lations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C. F. R. § 240.10b-5: "Employment of manipulative and deceptive devices":

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

The Proceedings Below

This is an action by the Securities and Exchange Commission (the Commission) against the Texas Gulf Sulphur Company (Texas Gulf) and certain of its directors, officers and employees, charging them with fraud

and deceit in violation of Section 10(b) of the Securities Exchange Act of 1934 (the Act) and Rule 10b-5 promulgated thereunder (R. 2851-85).* Trial proceeded without a jury on the issue of whether defendants violated Section 10(b) and Rule 10b-5, the Court reserving the issue of remedy for later hearing (App. B, 1). The District Court exonerated Coates, who at all times relevant herein was a director of Texas Gulf, holding that his purchases of Texas Gulf stock did not constitute a device, scheme, or artifice to defraud or an act which operates or would operate as a fraud or deceit upon any person within the meaning of Section 10(b) and Rule 10b-5 (App. B, 41-44). The Court of Appeals reversed (App. A, 3595).

The Commission's Charges

This action arises out of Texas Gulf's exploratory activities near Timmins, Ontario, in late 1963 and early 1964. The first exploratory drill hole was completed on November 12, 1963 and further exploratory activities proceeded thereafter. At a news conference held in New York City on April 16, 1964, Texas Gulf announced the existence of a major discovery at Timmins (App. A, 3596-3604).

The complaint charges Texas Gulf with issuing a misleading press release on April 12, 1964, regarding its Timmins exploratory activities. The individual defendants are charged with fraud and deceit by reason of purchasing, advising others to purchase or accepting options from Texas Gulf to purchase shares of Texas Gulf stock at varying dates from November 12, 1963, to the close of business on April 16, 1964. Coates and Lamont (who is since deceased and not a party to the appeal below) were

---

*The Record on Appeal is cited "R. ——". The Appendices to this Petition are cited as "App. —— ".

the only defendants charged with violating Section 10(b) and Rule 10b-5 by reason of purchasing Texas Gulf stock or allegedly advising others to purchase it after the conclusion of Texas Gulf's April 16 New York press conference (R. 2851-85; App. A, 3593 fn. 6).

The Commission's charges against Coates are predicated solely upon the fact that after the conclusion of the April 16 press conference he telephoned his broker (who is also his son-in-law) and ordered 2,000 shares of Texas Gulf stock to increase the holdings of that stock by several family trusts. The Commission charged that Coates thereby violated Rule 10b-5 and that his violation encompased not only his purchase of 2,000 shares but also included purchases made by his broker for other accounts on both the morning and afternoon of April 16 (R. 2879-81).

The Facts Relating to Coates

Coates telephoned his broker only after the following sequence of events:

(1) On April 12, following wide press coverage of rumors of the Timmins discovery, Texas Gulf announced that a release would be forthcoming about the Timmins project* (R. 1132-37, 1149-51, 1224-27, 2874-75).

(2) Coates, a senior member of the Houston law firm of Baker, Botts, Shepherd & Coates and a director of long service of Texas Gulf, first learned of the Timmins project from the *Wall Street Journal* of April 13 which carried the Company's April 12 release (R. 132-33, 176, 144-46, 1256).

---

*The April 12 release stated in part:
"When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project." (R. 2874-75)

(3) Coates arrived in New York on April 15 from his home in Houston to attend a regularly scheduled meeting of the Texas Gulf Board of Directors on April 16 (R. 145-46). On arrival, he went to the Company's offices and while there read a draft of the announcement of a "major discovery" then being prepared for release at a news conference which had been called for 10:00 a. m. on the following day (R. 146-47). Coates was told on April 15 that the Minister of Mines of the Province of Ontario would make an announcement of the Timmins discovery at 11:00 p. m. that night and understood that the announcement would be made on radio and television (R. 147). Coates also saw a list of the persons invited to the New York news conference (R. 147-48).

(4) Coates, who had for some time contemplated adding to his holdings of Texas Gulf stock, had by then decided to buy additional shares but to wait to do so until after the scheduled news conference (R. 151-52, 155-59, 172-73).

(5) On the morning of April 16, the *Northern Miner,* a widely circulated and respected Canadian mining publication, carried an officially sanctioned banner story concerning the Timmins discovery (App. B, 34-35; R. 993-99, 2183-84, 2228-30). Information from the *Northern Miner* article was relayed to brokers in New York prior to the opening of the New York Stock Exchange on April 16 (App. B, 35; R. 2180-2207, 2230-31, 2277-91, 2342-52, *inter alia*). From that and other sources, news of the Company's confirmation of the ore strike was known throughout the financial community prior to the opening of the market on April 16,

with the result that trading on the opening of the market was "wild" (R. 2277-91, 2355-62, 2521-27).

(6) At the Board of Directors' meeting at 9:00 a. m. on April 16, the President of the Company stated that the announcement by the Minister of Mines had been made in Toronto the preceding night (R. 1207-11, 1270). The announcement was in fact not made until 9:40 a. m. on April 16, but the error was not discovered or conveyed to Coates for some days after April 16 (R. 163-65, 1005-08, 1210-11, 1270).

(7) At the news conference at 10:00 a. m. on April 16, the representative of the Dow Jones Instant News Service was present, along with other reporters and representatives of brokerage houses (App. A, 3603; R. 2446-50, 202-04, 1266-69). Stephens, the President of the Company, announced that "Texas Gulf Sulphur Company has made a major strike of zinc, copper and sulphur in the Timmins area of Ontario, Canada", and read further from the prepared text which had been handed to the reporters and brokers' representatives (App. B, 40; R. 90, 2451). Some reporters left upon the first sentence, others stayed until the end (R. 165, 205, 2388, 2423). The Dow Jones representative was among the first to leave and telephoned the news for instant dissemination in a series of three "takes", the first of which, announcing the existence of a confirmed mine, should have appeared in every brokerage house within two or three minutes (R. 2450-54). (For unexplained reasons, there was in fact a delay of some 45 minutes before the news appeared on the broad tape at 10.54 a.m. (App. A, 3619, fn. 19)).

It was only after the news conference ended that Coates telephoned his broker to place an order and told him that there had been a public announcement of the Timmins discovery (R. 151-52, 160-62). At the time he telephoned his broker Coates believed that the announcement had already appeared on the Dow Jones broad tape (R. 166).

The Opinions Below

The District Court

The District Court dismissed the complaint as to Coates holding that the evidence established that Coates telephoned his broker only after the New York press conference concluded and that his purchases did not constitute a device, scheme, or artifice to defraud or an act which operates or would operate as a fraud or deceit upon any person within the meaning of Section 10(b) or Rule 10b-5 (App. B, 41-44).

The District Court held that it was not fraud or deceit for a director to purchase shares on the basis of material information once that information has been announced, stating that it is the "generally accepted rule that it is the making of the announcement that controls." (App. B, 42) The District Court rejected the Commission's argument that the Court should fix a reasonable waiting period after an announcement is made, during which insiders cannot purchase, noting that "the Commission has not supplied, nor has the Court found, decisions specifying a waiting period after a corporate announcement is made." (App. B, 44). The Court stated that "if a waiting period is to be fixed, this could be most appropriately done by the Commission, which was established by Congress with broad rule-making powers." (App. B, 44).

The Court of Appeals

The Court of Appeals reversed the District Court holding that Coates' telephone call to his broker after the press conference concluded constituted fraud and deceit in violation of Section 10(b) and Rule 10b-5. The Court stated that "at the minimum Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow Jones broad tape . . ." (App. A, 3618-19). The Court noted that Coates honestly believed that the news had been disseminated when he telephoned his broker but held that Coates' belief was not a defense to a charge of fraud and deceit because, in the Court's view of the evidence, it was not reasonable to anticipate that the news would appear on the broad tape until 10:22 a.m (App. A, 3619 fn. 20, 3622)—two minutes after Coates placed his order.

REASONS FOR GRANTING THE WRIT

The Court of Appeals decided incorrectly questions of federal law which are of great importance to all corporate officers, directors and employees. Those questions have not been and should be decided by this Court.*

---

*The judgment of the Court of Appeals, although interlocutory, is appropriate for review because it involves important and clearly defined issues of law fundamental to the further conduct of the case. See *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964); *Land* v. *Dollar*, 330 U. S. 731 (1947); *United States* v. *General Motors Corp.*, 323 U. S. 373 (1945).

The unprecedented publicity given to the Court of Appeals' decision in this case and to comments thereon is an indication of the importance of and widespread interest in the issues presented herein. See, *e.g.*, *N. Y. Times*, Aug. 28, 1968, p. 46, Sept. 12, 1968, p. 71, Oct. 13, 1968, § 3, p. 1; *Wall St. Journal*, Aug. 29, 1968, p. 24. In October 1968, more than 1,000 persons attended a two-day seminar sponsored by the Practising Law Institute in New York on the

I

IT IS NOT FRAUD OR DECEIT FOR A DIRECTOR TO PURCHASE STOCK ON INFORMATION WHICH HAS BEEN PUBLICLY ANNOUNCED AT A NEWS CONFERENCE.

(a) Section 10(b) and Rule 10b-5 do not prohibit the use of inside information in the absence of fraud or deceit.

The Court below construed Section 10(b) and Rule 10b-5 as if they circumscribe a director's use of inside information even if such use is neither fraudulent nor deceitful. In that construction, the Court below ignored (a) the clear language of the Statute and Rule and (b) the legislative history of Section 10(b).

Rule 10b-5, so far as relevant here, makes unlawful "any device, scheme or artifice to defraud" and "any act, practice or course of business which operates or would operate as a fraud or deceit upon any person".*

In applying the Rule to transactions by insiders, the Court below made no attempt to track the language of the Rule or to demonstrate by analysis how petitioner's acts

---

Texas Gulf Sulphur decision. The Director of the Institute described that seminar as "the greatest turnout ever in the entire field of corporate law". Richard V. Bandler, Associate Regional Administrator of the Commission in New York was quoted by the *New York Times* as saying that attendance at the seminar was "certainly . . . an indication of great confusion and wide interest." *N. Y. Times*, Oct. 13, 1968, § 3, p. 1.

*The only duty of disclosure created by Rule 10b-5 is contained in subdivision 2, which makes it unlawful "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." That subdivision has no applicability to the charges against Coates since he concededly made no statements in connection with his purchase. Apart from that subdivision, Rule 10b-5 does not deal with non-disclosure except to the extent that non-disclosure might constitute fraud or deceit, *i.e.*, if special circumstances created a duty to disclose so that silence would be misleading.

came within the Rule's prohibition against fraud. Rather, the Court stated merely (App. A, 3606):

> ". . . The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has 'access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone' may not take 'advantage of such information knowing it is unavailable to those with whom he is dealing,' i.e., the investing public. *Matter of Cady, Roberts & Co.*, 40 SEC 907, 912 (1961) . . ."*

In other words, the Court interpreted Rule 10b-5 not as a rule prohibiting acts which would operate as a fraud or deceit but as a rule of "fair conduct" in trading by insiders. The absence of analysis is understandable since there is no logical basis for concluding that the mere placing by an insider of an order to *buy* stock on the New York Stock Exchange could have induced any owner of Texas Gulf stock to *sell*. By contrast, in determining whether Texas Gulf's April 12 press release was issued "in connection with the purchase or sale of any security" as that phrase was used in Section 10(b), the Court below stated that the acts which Congress intended to prohibit were those "of a sort that would cause reasonable investors to rely thereon" and thus "cause them to purchase or sell a corporation's securities." (App. A, 3630) It is beyond cavil that the mere placing by an insider of an order to buy stock on a securities exchange would not cause an investor

---

*The *Cady, Roberts* opinion was written by the Commission as part of a stipulated settlement and was, of course, not subject to judicial review.

to rely thereon and thus purchase or sell securities and is not an act which Congress intended to prohibit by Section 10(b).

In enacting the Securities Exchange Act of 1934, Congress was fully aware of the problems involved in stock trading by insiders. It treated such problems in Section 16 of the Act as separate and distinct from its treatment in Sections 9 and 10 of the Act of manipulative practices such as pooling arrangements, wash sales and matched orders. See Senate Reports Nos. 792 and 1455 (73d Cong., 2d Session, 1934).

The matter of trading on the basis of inside information was dealt with in Section 16 by providing for recovery of profits in the case of short-term trading and by reporting requirements in the case of long-term investment. The reasons for that treatment are stated in *Blau* v. *Max Factor & Co.*, 342 F. 2d 304 (9th Cir.), *cert. denied,* 382 U. S. 892 (1965), where the Court said (at 308):

> "The reasons which led Congress to declare insider profits on stock transactions forfeit only when purchase and sale occurred within less than six months, though not spelled out in the legislative materials, are nonetheless clear. Improper use of inside information by corporate insiders is most likely to occur in short-term, in-and-out trading. The temptation to trade upon inside information is enhanced when the period for which capital must be committed is short. And ordinarily the useful life of 'confidential' inside information is brief. The evidence upon which Congress acted indicated that the abuse occurred almost entirely in short-swing transactions. Moreover, few if any reasons could be advanced for encouraging such trading by insiders. On the other hand, in long-term investment the risk

> of abuse of inside information was relatively slight, and the affirmative value of long term personal financial commitments by insiders to the prosperity of the companies which they controlled was obviously great. Thus, by basing forfeiture of profits upon the length of the insider's investment commitment, Congress sought to minimize misuse of confidential information, without unduly discouraging bona fide long-term investment."

Petitioner does not contend that Section 16 preempts the field and that an insider's purchases, if fraudulent, would not violate Section 10(b) and Rule 10b-5. However, the fact that an insider's purchases, in the absence of fraud, were specifically regulated by Section 16 makes clear that Congress did not intend Section 10(b) to prohibit purchases on the basis of inside information unless those purchases also involved the separate and additional ingredients of fraud or deceit.

The restrictions on insider purchases superimposed on Rule 10b-5 by the Court below and applied retroactively to Coates may be proper subjects for legislation or the exercise of the Commission's rule-making powers, both of which operate prospectively. However, the question posed herein is not whether such restrictions may be proper or desirable but whether the challenged conduct comes within the existing Rule 10b-5 proscription against fraud and deceit.

> **(b) A director is not under a duty to disclose information which has already been announced by the corporation. In the absence of such a duty mere non-disclosure cannot constitute fraud or deceit.**

The charge against Coates is based upon the Commission's contention, accepted by the Court below, that under

Section 10(b) and Rule 10b-5 insiders may not purchase their corporation's securities without disclosing inside information to the seller and in the absence of disclosure the insider must abstain from buying. However, the only duty of disclosure created by Rule 10b-5 is contained in subdivision 2, which has no applicability to the charge against Coates. The other subdivisions of Rule 10b-5, *i.e.*, subdivisions (1) and (3), merely create a statutory liability for "fraud or deceit" and while one of the elements of fraud or deceit may be predicated upon the breach of a duty to disclose, such duty is not created by Rule 10b-5. Therefore, the question whether or not such duty exists depends on independent principles of law. In the context of a claim of fraud, mere nondisclosure is without legal significance unless the circumstances are such as to create a duty to disclose, so that nondisclosure is equivalent to misrepresentation.

The court below based its conclusion that subdivisions (1) and (3) should be read as if they create a duty of disclosure on what it termed (a) traditional fiduciary concepts and (b) the "special facts" doctrine enunciated by this Court in *Strong* v. *Repide,* 213 U. S. 419 (1909). However, it is settled law that no fiduciary duty is imposed upon officers and directors of a corporation which precludes them, merely because of their knowledge of inside information, from buying or selling the stock of their corporation. *Strong* v. *Repide, supra*; Securities Exchange Act of 1934, § 16 (15 U. S. C. § 78p); *SEC* v. *Chenery Corp.,* 318 U. S. 80, 88 (1943). Although courts have held that an insider has a duty to disclose if "special facts" exist, Coates' acts did not involve any of the facts and relationships which conceivably could be held to create a duty to disclose.* The

*As in *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U S. 180 (1963), where a registered investment adviser communicated only partial information to his clients to induce them to buy so that he could secretly sell after the price had advanced; or *Speed* v. *Trans-*

Court below apparently believed that the materiality of the information could itself be regarded as a "special fact" giving rise to a duty to disclose. But materiality is an independent element of fraud and this Court's opinion in *Strong* v. *Repide*, *supra*, makes clear that something more than the materiality of the information is required to constitute the special facts creating such duty.

In the absence of special facts, a corporate director is not under any duty to make disclosure of his knowledge of corporate affairs. It approaches absurdity to say that a seller of stock having routinely placed his order to sell on a securities exchange, without inquiry as to the expected Texas Gulf announcement, was entitled to expect that if any of his stock happened to be matched with a buy order of an insider, the buyer would communicate with him to disclose any material facts known to him.

Even if one were to assume, for purposes of argument, that a director possessed of inside information must disclose it prior to purchasing shares in the company, any such duty would cease when the company itself makes the disclosure. As of the moment that information is publicly announced it is "no longer available only for a corporate purpose" and is no longer inside. The information may, of course, be acted upon immediately by members of the public without any requirement that they make any disclosures to the persons with whom they are dealing. The corporate director has no less freedom of action.

---

america Corp., 99 F. Supp. 808 (D. Del. 1951), modified on other grounds 235 F. 2d 369 (3d Cir. 1956), where a corporation, by withholding inventory data from financial statements, induced minority stockholders to sell their stock; or *Cochran* v. *Channing Corp.*, 211 F. Supp. 239 (S. D. N. Y. 1962), where a majority shareholder operated a scheme for depressing the market price of stock and buying out the minority.

Coates did not place his order and his transactions did not take place until after the corporation's public release at the news conference. Coates had no duty to make any disclosures in addition to those already made by Texas Gulf and he had no duty to wait for some undefined additional period of time before placing his order.

It may or may not be desirable to adopt a rule prescribing a waiting period for insiders in connection with the announcement of significant corporate news. But this is not a rule-making proceeding. In so far as Coates is concerned, the question is whether the fact that he purchased stock immediately after the public announcement "operated as a fraud or deceit." The news conference was attended by representatives of major brokerage firms who were free to and did make use of information presented at the meeting without any waiting period (R. 2385-90, 2424-26, 2432-34). Indeed, as noted by the Commission (Commission's Brief as Appellant in the Court of Appeals, p. 71), even a reporter could have called his stock broker before he called his office.

The contention that Coates had a duty to wait for a period of time following the public announcement has nothing to do with fraud or deceit but it is an unwarranted attempt to expand upon the inhibitions placed on insider trading by Section 16(b) of the Act. An analogous attempt (supported by the Commission as amicus) to expand the application of Section 16(b) was rejected by this Court in *Blau* v. *Lehman,* 368 U. S. 403 (1962).

The announcement by Texas Gulf at its news conference at 10 a. m. on April 16, 1964, was the culmination of a series of steps serving to inform stockholders and the public of the Timmins discovery. Accordingly, even if a corporate director had a duty to disclose inside information, the information ceased to be inside and any such duty terminated when the Timmins discovery was announced at the news conference.

II

A DIRECTOR'S PURCHASE OF STOCK ON INFORMATION WHICH HE BELIEVES TO BE AVAILABLE TO THE PUBLIC DOES NOT CONSTITUTE FRAUD OR DECEIT UNDER SECTION 10(b) OR RULE 10b-5.

We recognize, of course, that not every claim of fraud requires proof of all the elements of fraud required to establish a claim for damages. In no case or proceeding, however, prior to this one, has a defendant been held to have violated subdivisions (1) or (3) of Rule 10b-5, or any comparable provision, in the absence of proof of knowledge of falsity or deception. Thus, even if Section 10(b) and Rule 10b-5 are held to preclude insider trading on the basis of material inside information a corporate director cannot be held to have engaged in fraud and deceit in violation of that rule unless he knew that the information was still "inside" information.

The necessity of proving knowledge was specifically noted by the Court below in its statement that it is the essence of Rule 10b-5 that a director may not take advantage of information " 'intended to be available only for a corporate purpose' . . . *'knowing* it is unavailable to' . . . the investing public." (App. A, 3606. emphasis added) Nevertheless, in determining whether petitioner's good faith belief that the news was disseminated is a defense to a charge of fraud, the Court quite inconsistently held that it is not and that a director's honest error constitutes fraud. That holding appears to be based on an incorrect reading of this Court's opinion in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963). In that action this court held that in a proceeding under the Investment Advisers Act against a person subject to the supervision of the Commission, fraud could be established without proof of either "intent to injure" or "actual injury to the client". It did

not hold that negligence may be equated with fraud and expressly found the element of scienter to be present:

> "It is clear that respondents' failure to disclose the practice here in issue was purposeful, and that they intended that action be taken in reliance on the claimed disinterestedness of the service and its exclusive concern for the clients' interests." (375 U. S. at 192 fn. 39)

When Coates telephoned his broker after the April 16 news conference, he believed that Texas Gulf's Timmins discovery was no longer inside information. The record establishes that Coates' belief was a proper and reasonable one:

1. The public had been alerted on April 12, following widespread publication of rumors about a fantastic Texas Gulf discovery,* that a significant statement concerning the Timmins project would shortly be forthcoming (R. 1132-37, 1149-51, 1224-27, 2874-75).

2. At the Board meeting on April 16, Coates was informed (although erroneously) that the Ontario Minister of Mines had announced the discovery the night before and he assumed that it had been transmitted to New York brokerage houses through their wire connections with Canadian brokers (R. 171-72).**

---

*The *New York Herald Tribune* front page article on April 11 referred to "the biggest ore strike since gold was discovered more than 60 years ago in Canada. . . ." (L-CX B)

**The Court of Appeals found that the announcement made by the Ontario Minister of Mines was not the equivalent of the announcement made by Texas Gulf in New York on April 16 (App. A, 3622). But the differences between the text of the New York press release (R. 58; Px. 19) and the announcement made by the Ontario Minister of Mines (R. 1023; Px. 74) are irrelevant to the question whether Coates' belief was reasonable. President Stephens did not read the text of the Minister's statement to the Board and did not give the Board members any indication that the Minister's announcement, which Stephens believed had been made the night before, differed in any material respect from the one to be made by Texas Gulf after the Board meeting (R. 1203-11).

3. The news conference that followed the Board meeting was attended by more than 22 representatives of the press, wire services and brokerage houses, including representatives of Dow Jones and of the brokerage firms of Merrill Lynch, Pierce, Fenner & Smith and Francis I. du Pont & Co. (R. 1266-69).

4. It was entirely reasonable for Coates to believe that news of the Timmins ore strike would be on the broad tape within minutes after the reporters left the press conference to make telephone calls. The entire conference lasted 10 to 15 minutes (R. 92, 151). Bishop, a staff reporter for Dow Jones, left the press conference shortly after it started and immediately telephoned the story to Dow Jones (R. 151-52, 165, 205, 2451-53). Coates assumed from his prior experience that the report would be on the broad tape in a matter of minutes (R. 166-68, 170). Bishop testified that if Dow Jones had followed its normal procedure, the news would have appeared on the broad tape within 2 to 3 minutes after he dictated it (R. 2454). Significantly, the first sentence of the Dow Jones transmission contained the full disclosure, *i.e.*, "Texas Gulf Sulphur Co. said its ore discovery in Ontario is—a major discovery of zinc copper and silver—" (R. 58; Px. 20, pp. 16-18).

The Court of Appeals' conclusion that Coates was negligent in believing that the news had appeared on the broad tape by 10:20 a.m. was based on its finding—a finding not made by the trial court—that the news could not have appeared until 2 minutes later, *i.e.*, 10:22. However, that finding reflects a misunderstanding of Bishop's testimony.*

*The Court of Appeals assumed that transmission on the broad tape begins only after the full story is dictated. However, Bishop

The record demonstrates that had Dow Jones followed its normal practice, the announcement of Texas Gulf's Timmins discovery would have been on the broad tape no later than 10:13 to 10:18, thereby confirming the reasonableness of Coates' belief that the news had already appeared on the broad tape when he telephoned his broker shortly before 10:20 a.m. His purchase, therefore, cannot on any theory constitute fraud or deceit under Section 10(b) or Rule 10b-5.

III

IF RULE 10b-5 IS NOW CONSTRUED TO MAKE UNLAWFUL A DIRECTOR'S PURCHASE OF STOCK ON INFORMATION WHICH HAS BEEN PUBLICLY ANNOUNCED AT A NEWS CONFERENCE THE RULE AS SO CONSTRUED IS INVALID UNDER THE FIFTH AMENDMENT FOR FAILURE TO PROVIDE AN ASCERTAINABLE STANDARD OF CONDUCT.

It is a fundamental constitutional requirement that administrative rules and regulations imposing civil or criminal** liability provide an ascertainable standard of conduct so that those subject to the law will know what it is they are prohibited from doing. *A. B. Small Co.* v. *American Sugar Refining Co.*, 267 U. S. 233 (1925); *Kraus & Bros., Inc.* v. *United States*, 327 U. S. 614 (1946); *Boyce Motor Lines, Inc.* v. *United States*, 342 U. S. 337 (1952); *Keyi-*

---

testified that a story is dictated in segments or "takes" and that transmission begins immediately after the first take. Bishop testified that his telephone conversation with his office lasted 10 minutes and that the 10 minutes consisted of a "first take", "a wait" and a "second take". He stated that news normally appears on the broad tape within 2 to 3 minutes after the first take is dictated (R. 2453-54).

**While criminal penalties are not invoked in this case, violation of Rule 10b-5 is nevertheless punishable by fine and imprisonment. Section 32(a), 15 U. S. C. § 78 ff(a).

shian v. *Board of Regents,* 385 U. S. 589 (1967); *Boutilier* v. *Immigration and Naturalization Service,* 387 U. S. 118 (1967); *Matter of Ruffalo,* 390 U. S. 544 (1968).

As this Court stated in *Kraus & Bros., Inc.* v. *United States, supra*:

> ". . . The dividing line between unlawful evasion and lawful action cannot be left to conjecture. The elements of evasive conduct should be so clearly expressed by the Administrator that the ordinary person can know in advance how to avoid an unlawful course of action." (327 U. S. at 621-22)

The Court below construed antifraud Rule 10b-5 to apply to conduct untainted by fraud and to prohibit stock purchases by a director even after corporate information had been publicly announced. The standard of conduct which the Court below has thus read into Rule 10b-5 is not one which a reasonable man could divine from either Section 10(b) or Rule 10b-5 and the Court's retroactive application of that standard to Coates contravenes his basic constitutional rights.

Rule 10b-5 was adopted in 1942, its language having been taken substantially unchanged from Section 17 of the Securities Act of 1933. It was not until 1961 that the Commission first suggested that such language might be applied to buying or selling on the market on the basis of undisclosed inside information, in the absence of any misleading statement or conduct. *Matter of Cady, Roberts & Co.,* 40 S. E. C. 907. In that case, on a stipulated settlement, a partner of a brokerage firm was held by the SEC to have violated Rule 10b-5 by trading on the basis of information about a dividend reduction given to him by a director of the company prior to its public release. In that case,

the means selected for public release was not a news conference but, instead, communications to the New York Stock Exchange and Dow Jones. Both messages were inadvertently delayed in delivery. The announcement appeared on the Dow Jones broad tape three minutes after it was received (40 S. E. C. at 909) but, in the meantime, the transactions there in question had taken place. The SEC made no charge against the director, stating merely that he "probably assumed, without thinking about it, that the dividend action was already a matter of public information. . . ." (40 S. E. C. at 917)

By its decision in *Cady, Roberts,* the Commission disclosed for the first time its view that Rule 10b-5 could be construed to prohibit insider transactions without disclosure of inside information but it did not anywhere suggest that anything more was required that a public release of the information. On the contrary, the Commission stated:

> ". . . all the registered broker-dealer need do is to keep out of the market until the established procedures for public release of the information are carried out. . . ." (40 S. E. C. at 915)

In 1965, in its original complaint in this case, the Commission expanded its 1961 interpretation to require not only the carrying out of the procedure established for public release of information—here the news conference—but also the subsequent report of the announcement on the Dow Jones broad tape. It accordingly sought to impose liability on Coates for transactions that took place between the two events but did not then assert any claim against defendant Lamont for transactions after the report was carried on the broad tape.

In April 1966, just prior to the commencement of the trial of this case, the Commission further expanded its

interpretation of the Rule to include (by amendment to the complaint) a claim against Lamont for purchases in the afternoon on April 16, 1964, well after the appearance of the announcement on the Dow Jones tape (R. 4785).

In December, 1966, in its brief as Appellant in the Court of Appeals the Commission suggested still a different interpretation of the Rule, stating that insiders should not trade until the news appears "in the morning newspapers" and that a considerably longer time may be required to provide stockholders with some opportunity to evaluate the news and "consult with their advisers." (pp. 74, 75).

No Commission rules or regulations even purport to govern by express terms the purchase of stock after corporate announcements, and the Commission has conceded that there is "no court decision specifically involving the question when information has been sufficiently disseminated so that insiders may trade . . . ." (Commission's Brief as Appellant in Court of Appeals, p. 75). The only conceivable guidance Coates could have had was the Commission's decision in *Cady, Roberts,* which stated that an insider must "keep out of the market until the established procedures for *public release* of the information are *carried out* . . ." [emphasis supplied], which is what Coates did, being "too old to get into trouble with the SEC" (R. 162).

The confusion engendered by the Commission's varying interpretations of the Rule is compounded by its refusal, even up to the present, to define the standard of conduct which it claims already exists in Rule 10b-5. In attempting to justify this refusal the Commission has conceded the absence of an ascertainable standard. Thus, the Commission attempts to justify its refusal on the grounds that: (1) it is "a nearly impossible task to formulate a rigid set of rules that would apply in all situations of this sort" (R. 2830); (2) "a standard is difficult to formulate" (R.

2838); (3) "standards that Congress and the Commission set must necessarily be stated in somewhat general terms, as they have been stated in Rule 10b-5" (R. 2848) and (4) "specific rules . . . would be undesirable" (Commission's Brief as Appellant in the Court of Appeals, p. 76).

If the Court of Appeals is capable of articulating a minimum *post hoc* standard* then the Commission should be capable of drafting, and required to promulgate a standard, prior to bringing an action for violation of the Rule. Even the Court of Appeals called upon the Commission, in its expertise, to exercise its rule-making power to "provide some predictability of certainty for the business community." (App. A, 3618 fn. 18)

Yet, the Commission has used the litigation that it instituted as a justification for its failure to promulgate guidelines.** Manuel F. Cohen, Chairman of the Commission, is reported to have asserted to the Investment Bankers Association of America on December 5, 1968, that "the Commission does plan to issue some guidelines . . ." but they haven't been issued yet "because it would be unseemly while various legal cases are still in the courts." *Wall Street Journal* Dec. 6, 1968, p. 15.

If the Commission itself, after more than 30 years experience with the Rule, has so much difficulty in deciding what construction to place upon it, it cannot reasonably be said that the Rule provides an ascertainable standard of conduct so that "the ordinary person can know in advance how to avoid an unlawful course of action".

---

*"[A]t the minimum, Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow-Jones broad tape . . . ." (App. A, 3618-19)

**The decision of the Court of Appeals frees the Commission from the necessity of promulgating regulations in advance and allows the Commission to assert a new "construction" of an existing regulation to be applied retroactively.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

January 3, 1969

Respectfully submitted

ALBERT R. CONNELLY
Attorney for Petitioner
One Chase Manhattan Plaza,
New York, N. Y. 10005

Of Counsel:

GORDON GOOCH
DONALD STRAUBER
CRAVATH, SWAINE & MOORE